

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

*Removing Obstacles To Increased* )  
*Electric Generation And Natural Gas Supply)* Docket No. EL01-47-000  
*In The Western United States* )

**COMMENTS OF THE  
CALIFORNIA ENERGY COMMISSION**

The California Energy Commission (CEC) respectfully and urgently requests that the Federal Energy Regulatory Commission (FERC) direct its attention to short term modifications to the wholesale market serving the Western states. As important as the many issues and actions in the March 14<sup>th</sup> order may be, they do not address the consequences to Western states of what Commission Massey, in his dissent, refers to as “the elephant in the living room.” The current market situation is not sustainable.

Without prompt and decisive FERC action, California and other Western states face the prospect of electricity and economic disaster this year. Stage 3 alerts and blackouts may become commonplace if electricity supply continues to be withheld from the market, and exorbitant wholesale electricity prices are a virtual certainty, even if all the measures proposed in the Order can be successfully implemented. The situation calls for rigorous exercise of FERC authority to assure “just and reasonable” wholesale prices, not just to protect the interests of consumers but to prevent market collapse.

In the years just before restructuring, California retail end-users annually spent upwards of \$7 billion on the electrical energy commodity. If wholesale prices continue at current levels, California Independent System Operator (CAISO) electricity users this

year will pay \$19 billion, needlessly transferring an additional \$12 billion over and above the \$7 billion into the hands of a few power sellers during calendar 2001, yet not receive the substantial additional power that sum should command. If prices skyrocket further as the summer months increase demand, it has been estimated that the total expenditure on electricity could reach \$70 billion in California alone, according to Dr. Frank Wolak<sup>1</sup> of the CAISO's Market Surveillance Committee. The electricity costs California currently experiences and can expect this summer are not justifiable. Moreover, they are well above the level needed to stimulate power plant development and are not sustainable.

California is implementing a comprehensive and aggressive billion dollar plan to increase generation and reduce demand for the summer 2001 and beyond. In addition, the California Public Utilities Commission (CPUC) recently approved large retail rate increases, the structure of which will likely enhance conservation and efficiency. Given these actions, which demonstrate California's commitment to creating long term energy stability for California and the West, The California Energy Commission urges the FERC to do its part in the short run and ensure just and reasonable wholesale rates until the market become functional.

Few outside the state seem aware that as of March 21, 2001, the Commission has already licensed 8,464 MW of new central station generation in various stages of construction that will be operational between this summer and 2003.<sup>2</sup> Over 1300 MW of this capacity is expected to be on line in the summer of 2001. There are also more than 5,000 MW of additional capacity currently under siting consideration at the California

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<sup>1</sup> Wolak, F., "Proposed Market Mitigation Plan for California Electricity Market" (February 6, 2001.)

Energy Commission<sup>3</sup> and another approximately 8,000 MW from applicants who have notified the Commission that they will apply for operating certificates during the next year.<sup>4</sup> In addition, since last August Governor Davis has twice used his executive authority to streamline the power plant permitting process to shorten the process for various facilities. Among these are 4 -month, 60-day and 21-day power plant approval processes. Through implementation of these provisions, which is the highest priority for the CEC and air regulators, we expect the addition of over 2,000 MW of peaking power plants to be available this summer and later this year. These efforts are accompanied by Executive Orders that require that air quality permits be temporarily amended to permit extended hours of operation of all existing generation facilities. Furthermore, delays in installation of pollution control equipment have been authorized to ensure all major existing facilities are available this year.

In addition, California is implementing a wide range of energy efficiency and demand reduction measures. Governor Davis has proposed approximately \$500 million in additional energy efficiency programs to gain over 3,600 MW in peak demand reduction. Legislation is proceeding in a special session to support this effort, targeted for the summer, with funding by general tax revenues. The Governor has also established the “20/20” rebate program that rewards those who save 20 percent in electricity consumption this summer over last year’s use with a 20 percent rebate.

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<sup>2</sup> See <http://www.energy.ca.gov/sitingcases/approved.html>

<sup>3</sup> See <http://www.energy.ca.gov/sitingcases/current.html>.

<sup>4</sup> See <http://www.energy.ca.gov/sitingcases/anticipated.html>.

In two separate actions in calendar 2001, the California PUC has voted to increase rates a total of four cents per kWh, or about one-third for small customers and 50 percent for larger customers. As a result, California will have among the very highest, if not the highest, retail electricity prices in the contiguous United States. New retail rate structures under development are expected to further reinforce consumer participation in energy efficiency measures.

Although we recognize that there is a role for high prices in providing the incentives required to attract capital for new power plants and transmission lines, prices in the West have already gone far beyond the point of being effective for that purpose. The projects currently under construction have already responded to electricity prices; they cannot respond again. For those not yet under construction, the State itself has negotiated and continues to offer long term contracts to encourage continued power plant development. Continued or increasing high prices beyond any reasonable level, instead of causing more plant applications this year, will simply aggravate a burden-of-payment and credit crisis that increasingly clouds the financial outlook for both existing and new projects.

Runaway wholesale prices have brought the three California utilities to the brink of bankruptcy, forcing the State government to take over as buyer for consumer load. The same financial burden now threatens the State's credit rating and its ability to support vital services. Even generating companies, some of which have reported record profits for 2000, realize diminished benefit from a market in which they get high prices

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but cannot count on receiving payment. The FERC's continuing support for markets cannot mean the dysfunctional process that has existed since June 2000. In that process, generators submit invoices with "prices" anticipating steep discounts, utilities (and now DWR) pile up the "debt" but make few if any payments, and courts order generators to supply imbalance energy to the CAISO even though no payments exchange hands. Real markets mean real transactions entered into voluntarily with real payments made on time. The CEC urges FERC to work with the states to re-establish such a market.

The CEC respectfully and urgently requests the FERC to act now to protect both Western region electricity consumers and wholesale sellers from the pattern of "unjust and unreasonable" prices experienced in the industry in recent months. The CAISO has appealed to FERC to require rebates for \$5 Billion of excess wholesale generation charges during 2000. Even more significant is the going forward situation. There are no more power plants to be gained this year by permitting additional tens of billions of dollars to shift from tens of millions of Western electricity consumers to the bottom line of a few energy corporations. This issue is closely tied to the exercise of market power, which threatens overall system reliability and exacerbates economic distortions. Current rules approved by the FERC permit, and even encourage, suppliers to withhold power from the market to generate less electricity but more profits at higher market prices. In the event power is withheld in the future – for whatever reasons – then the entire Western region's reliability becomes increasingly "brittle", vulnerable to cascading disruptions as generation falls below demand. Further, if uncontrolled prices cause businesses to fail for their inability to absorb the new costs, the West – and potentially the rest of the

interconnected United States – could experience losses on a scale well beyond “just” the electricity market. Business failures reduce employment, productivity and tax revenues while increasing demands for government services such as welfare and unemployment payments.

The CEC urges the FERC to do now what many have advocated – take effective actions to reduce wholesale power generation prices to just and reasonable levels in the short term until the market is functional. There are at least three options that could be considered: (1) directly control regional (Western Interconnection) prices, (2) institute requirements that all generators and other sellers that hold positions in the region in excess of their need to serve native load enter into long term supply contracts with load serving entities that are short of their need to serve native load, or (3) institute cost-based bidding in all regional markets. Each is an intrusion into the free market, but the Western electricity markets are currently neither free nor competitive. Imposing temporary caps or contracting requirements while the market becomes functional and competitive is a reasonable thing to do for a limited period of time. We briefly elaborate on each of these options.

## **1. Price Cap**

On March 9, 2001, the governors of California, Oregon and Washington wrote to the FERC requesting a temporary spot market price cap in the Western interconnection equal to cost plus \$25/MWh. To illustrate the impact of this, consider a base load plant making \$25/MWh for 744 hours of a 31-day month. This would clear \$18,600 per MW toward fixed costs and profit. This is probably close to 20% of its annual revenue

requirements if it is a new combined cycle plant and somewhat higher percentage if it is an older plant. At this rate, electricity would be affordable, and generators would be appropriately compensated.

## **2. Institute Power Seller Contracting Requirements**

The December 2000 report of the CAISO Market Surveillance Committee and subsequent filings of its Chairperson – Dr. Frank Wolak – outlines a proposal to obligate generators to enter into multi-year contracts with load serving entities for 70 percent of their resource. Sellers that do so would bid into an uncapped spot market with their remaining energy. This proposal conforms to FERC’s previous support for reducing the importance of spot market purchases and the failure of the power sellers to willingly enter into such contracts in the interval since the December 15, 2000 FERC Order. Further, by requiring that these contracts be with a load serving entity, intermediate agents cannot absolve generators of responsibility. It is clear that California entities have signed, and would sign more such contracts were generators willing to do so. But generators and other sellers are now holding out for long term contracts that reflect expectations of their ability to exercise market power and charge unfair prices in the near term as a result of FERC’s unwillingness, so far, to place any significant control on prices. Dr. Wolak’s concept can be improved in two ways. First, it is necessary to extend requirements for long term contracting from simply generators to all power sellers because much of the generation has already be obligated in contracts to marketing entities. Second, the requirement should be extended from California entities to the entire Western

Interconnection. So modified, Dr. Wolak's concept provides a basis for controlling costs, maintaining a market for spot purchases, and assuring no within-Western Interconnection market rules that promote "megawatt laundering" and create reliability problems.

### **3. Cost-Based Bidding**

On March 15, 2001 the CAISO Board endorsed a staff proposal to require cost-based bid caps for all participants in CAISO markets. Clearly such a proposal preserves the elements of market-based selection of suppliers in satisfying loads, but eliminates the ability of a concentrated wholesale market to extract scarcity rents from purchasing agents on behalf of retail end-users. A formal CAISO Tariff Amendment to implement this concept is being developed at this time, and may be filed at any time.

### **Conclusion**

The CEC urges the FERC to either establish, or authorize the Western states, working in cooperation with FERC staff, to prepare and submit a detailed and implementable price control plan. The plan is needed as soon as possible so it can be effective for the summer of 2001.

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Respectfully submitted,

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